LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
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FISCAL IMPACT STATEMENT

LS 6004 **DATE PREPARED:** May 14, 2002
BILL NUMBER: HB 1001 (SS) **BILL AMENDED:**

SUBJECT: State and Local Fiscal Matters and Appropriations and Tax Restructuring.

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FUNDS AFFECTED: **X** **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
X **FEDERAL**

Summary of Legislation: (Amended) This bill has the following provisions.

(1) Phases in reassessment increases for residential property over four years.
(2) Increases the Property Tax Replacement Credit, the Homestead Credit, the Standard Deduction, the Research Expense Credit, the Earned Income Tax Credit, and the Renter's Deduction.
(3) Establishes an investment credit, a Multifamily Rental Complex Deduction, and an Inventory Tax refund.
(4) Limits the Gross Income Tax to public utilities, eliminates the Gross Income Tax exemption for certain pass through entities, and increases the tax rate.
(5) Increases the Sales Tax, the Corporate Adjusted Gross Income Tax, the Cigarette Tax, the Wagering Tax, and certain fees.
(6) Establishes the Business Supplemental Tax.
(7) Delays reduction of the Insurance Premium Tax rate.
(8) Authorizes the establishment of certain fees.
(9) Prohibits the closing of or staff reductions at certain state institutions.
(10) Authorizes dockside gaming and pari-mutuel pull tabs.
(11) Authorizes the location of a riverboat in a historic district in the towns of French Lick and West Baden.
(12) Makes certain appropriations, including an appropriation for distributions to tobacco farmers.
(13) Prohibits closure of certain facilities.
(14) Restores Gary Building Authority statutes to read as they did before amendments by P.L.178-2002 (HEA 1196).
(15) Establishes the County Support for Hospitals Program.
(16) Repeals the Riverboat Admissions Tax, the Supplemental Net Income Tax, and restructures the Hospital Care for the Indigent (HCI) program.
(17) Voids rules of the Department of Local Governmental Finance, including the shelter allowance and the personal property tax manual, and suspends the Department's rulemaking authority.
(18) Makes other changes.

Effective Date: Upon passage; January 1, 2002 (retroactive); March 1, 2002 (retroactive); March 28, 2002 (retroactive); June 1, 2002; July 1, 2002; December 1, 2002; January 1, 2003; January 2, 2003.

Explanation of State Expenditures:

Summary* — *Tax Restructuring Provisions: This bill contains several provisions that impact state expenditures and revenues. There is a net increase in estimated expenditures of $423.8 M in FY 2003, $1,140.6 M in FY 2004 and $1,250.2 M in FY 2005. Estimated net revenue increases total $432.1 M in FY 2003, $982.7 M in FY 2004, and $1,010 M in FY 2005. The net impact of the revenue increases over estimated expenditure is approximately $8.3 M in FY 2003. The fiscal impact of each provision is summarized in the table below.

Net Expenditure and Revenue Impacts -- Tax Restructuring Provisions

Provision	FY 2003	FY 2004	FY 2005
State Expenditures:			
Homestead Credit- Increase to 27.5%	$125.1 M	$337.3 M	$434.6 M
Inventory Prop Tax Replacement Credit	--	195.1 M	185.3 M
PTRC - Eliminate on All Property	(474.9 M)	(962.7 M)	(988.7 M)
PTRC- 22.5% on Real Prop, MH's, Indiv PP	325.8 M	660.4 M	678.2 M
School General Fund PTRF Credit	364.5 M	738.9 M #	758.9 M
School Transportation Fund PTRF Credit	83.3 M	171.6 M	181.9 M
Total Change in Expenditures	$423.8 M	$1,140.6 M	$1,250.2 M
State Revenues:			
$37,500 AV Credit	--	$96.0 M	$97.9 M
Business Supplemental Tax	$87.1 M	220.4 M	227.0 M
Corp. Gross Income Tax Elimination	(81.7 M)	(168.2 M)	(173.2 M)
Corp. AGI Increase/SNIT Elimination	37.2 M	76.6 M	78.9 M
Corp. Gross/AGI - Utility Taxes	49.5 M	102.0 M	105.0 M
Investment Tax Credit	(30.0 M)	(59.0 M)	(57.1 M)
Research Expense Credit	(23.0 M)	(47.9 M)	(51.5 M)
Renter's Deduction- Additional $2,000	--	(43.6 M)	(44.4 M)
Sales Tax - Additional 1%	393.0 M	806.4 M	827.4 M
Total Change in Revenues	$432.1 M	$982.7 M	$1,010.0 M
Balance to be Distributed to Tax Relief Fund	$8.3 M		

FY 2004 expenditure growth rates reflect the current revenue forecast and not the historical increases in these expenditures. Growth rates could be higher depending on future appropriations.

***Summary* — Budget Deficit Reduction Provisions:** This bill contains several provisions which result in a positive impact on the state General Fund. This is composed of estimated expenditure reductions totaling $128.8 M in FY 2002, $21.4 M in FY 2003, and $18.5 M in FY 2004. Estimated revenue increases total $3.9 M in FY 2002, $703.5 M in FY 2003, and $658.6 M in FY 2004. The fiscal impact of each provision is summarized in the table; additional details of the bill follow the table.

Expenditure and Revenue Impacts to the State General Fund -- Budget Deficit Reduction Provisions			
Provision	**FY 2002**	**FY 2003**	**FY 2004**
State Expenditures:			
Supplemental ADA Flat Grant	--	$35.0 M	--
Department of Education Grants ***	$5.2 M	30.2 M	--
ISTEP for Science and Social Studies	--	(0.8 M)	(0.9 M)
Higher Ed Operating Expenses	--	(29.0 M)	--
Higher Ed - Repair and Replacement ***	20.0 M	--	--
Higher Ed Technology Distribution	--	10.0 M	--
IN Commission on Health Care Excel.	0.05 M	0.05 M	--
Medicaid Spending	--	(16.7 M)	(22.3 M)
PTRC Distributions	(154.0 M)	--	--
State Police Funding	--	(54.8 M)	--
Tobacco Farmers Provisions	--	4.7 M	4.7 M
Total Change in Expenditures	($128.8 M)	($21.4 M)	($18.5 M)
State Revenues:			
Flexible Boarding/Graduated Wagering Tax/Admission Tax Elimination	--	$247.4 M	$262.7 M
Pari-mutuel Pull Tabs	--	--	5.3 M
Withholding on Gambling Winnings	--	15.0 M	15.0 M
Homeowner's Property Tax Deduction	–	56.0 M	--
Property Tax Add Back	--	91.7 M	77.8 M
Earned Income Tax Credit- 8% Fed. Credit	--	(14.0 M)	(34.3 M)
Cigarette Taxes	3.9 M	272.6 M	294.7 M
Premium Tax	--	3.9 M	11.7 M
Property Tax Representative Lic. Fee	--	0.04 M	0.04 M
Continuing Education Fees	--	0.02 M	0.02 M
IDEM and State Police Fees **	--	9.2 M	2.0 M
$2 Bed Fee on Nursing Homes	--	21.6 M	23.6 M
Total Change in Revenues	$3.9 M	$703.5 M	$658.6 M

**A portion of IDEM fee increases are deposited into dedicated funds and are not summarized in this table. The bill provides that the State Police may increase fees by rule and, thus, would depend upon administrative action.
***Allots funds appropriated by the General Assembly that the Budget Agency included in Budget Deficit Plan.

Tax Restructuring Provisions:

Homestead Credit Increase: Currently, Homestead Credits are equal to 10% of homeowners' property tax liability. The Homestead Credit percentage is scheduled to change to 4% in CY 2004. This provision would permanently set the Homestead Credit at 27.5% beginning in CY 2003. In CY 2001, Homestead Credits (at 10%) amounted to $195.5 M.

In addition to the increase in the Homestead Credit rate, the credits for school levies and the revisions to PTRC found elsewhere in this bill will also have an impact in the cost of providing homestead credits. Under the bill, homestead credit would be applied *after* PTRC credits have been applied. The following table summarizes all of the changes in this bill that affect the cost of the Homestead Credit. The school levy credits and PTRC changes were considered first. The resulting Homestead Credit cost serves as the base for the change in the credit percentage.

Summary of Homestead Credit Cost Change

Cal. Year	Current %	New %	Cost Change From School Credits / PTRC Change	Cost Change From Percentage Change	Total Cost Change
2003	10%	27.5%	($68.0 M)	$ 318.2 M	$250.2 M
2004	4%	27.5%	(28.5 M)	452.9 M	424.4 M
2005	4%	27.5%	(30.7 M)	475.5 M	444.8 M

The following table is a summary of the total Homestead Credit cost changes by state fiscal year.

Summary of Homestead Credit Cost Change

Fiscal Year	Total Cost Change
2003	$125.1 M
2004	337.3 M
2005	434.6 M

Inventory Tax Replacement Credit: Under this provision, the state would provide a 50% credit for property taxes due on inventory assessments. The credit would be provided in the form of a refund from the state to the taxpayer. The bill imposes a 2% growth limitation on the credit.

Estimation Issues: In estimating the impact of this provision, special attention was given to the impending real property reassessment. Reassessment will have a direct impact on property tax rates and the amount of the property tax levy that will be attributed to inventory. The real property reassessment will shift some of the property tax burden from personal property owners to real property owners. The total increase in assessed value, once the reassessment is fully phased in under this bill, is estimated at about 50.7%, taking the new real property rules and available deductions under this bill into account.

While it is difficult or impossible to estimate, the removal of 50% of the tax burden on inventory may provide an incentive for taxpayers to report more inventory in the state. Taxpayers who currently move inventory out of state may keep more of their inventory in Indiana. Also, the reduction of property tax on inventory may attract new operations that hold inventories. The estimated cost of the Inventory Tax Replacement Credit presented below is based on historical growth and known factors. If, in fact, this provision causes behavioral changes that result in higher levels of inventory, the actual cost of the credit will exceed the estimates below.

Data: According to the State Tax Board's Property Tax Analysis for various years, the net property tax on inventory equaled $406.9 M in CY 2000 and $427.6 M in CY 2001. The 2000 pay 2001 inventory AV was $4.70 B and has grown at an average annual rate of 2.7% over the last five years. The statewide net average property tax rate was $8.6955 per $100 AV in CY 2000 and $8.8151 per $100 AV in CY 2001.

Fiscal Impact: Future inventory assessed values were projected based on historical data. Future average property tax rates were estimated based on historical data, the school levy credits found elsewhere in this bill, and on the estimated changes to the total tax base due to the newly adopted real property assessment regulations. Based on estimates of future total tax levies and total assessed values, it is estimated that the statewide average gross tax rate will grow at a rate of about 1.6% per year in non-reassessment years. An estimate of the future gross property tax on inventory was computed by multiplying the estimated net assessed value of inventory by the estimated gross average tax rates. (Gross rates are used because business personal property would not qualify for PTRC payments under the bill.)

The table below shows the estimated net cost to the state to provide the 50% inventory credit beginning in CY 2003.

Estimated State Cost of 50% Inventory Tax Credit		
Calendar Year	**Fiscal Year**	**Credit Amount**
CY 2003	FY 2004	$195.1 M
CY 2004	FY 2005	$185.3 M

Property Tax Replacement Credit: Under current law, the state pays Property Tax Replacement Credits (PTRC) in the amount of 20% on most school and civil taxing unit operating fund levies. PTRC is currently paid from the Property Tax Replacement Fund, which is annually supplemented by the state General Fund.

Under this proposal, business personal property would no longer qualify for PTRC payments beginning in CY 2003. Real property, mobile homes, and non-business personal property would continue to qualify for PTRC payments and the PTRC rate would be increased from 20% to 22.5%. The PTRC expense was $886.5 M in CY 2001 and has grown at an average annual rate of 4.3% over the last five years.

In addition to the PTRC rate change and the change in property types that qualify for the credit, the school property tax credits found elsewhere in this bill will also have an impact in the cost of providing Property Tax Replacement Credits. The following table contrasts the cost of PTRC under current law and under the proposal.

Summary of PTRC Cost					
Cal. Year	**Current %**	**New %**	**Cost of PTRC under Current Law**	**Cost of PTRC under Proposal**	**Total Cost Change**
2003	20%	22.5%	$949.9 M	$651.6 M	($298.3 M)
2004	20%	22.5%	975.5 M	669.2 M	(306.3 M)
2005	20%	22.5%	1,001.8 M	687.2 M	(314.6 M)

The following table is a summary of the total PTRC cost changes by state fiscal year.

Summary of PTRC Cost Change	
Fiscal Year	**Total Cost Change**
2003	($149.1 M)
2004	(302.3 M)
2005	(310.5 M)

School General Fund PTRF Credit. The bill increases the current 20% state property tax replacement credit on school general fund levies to 41%. The school formula and school budget process remain unchanged. The school general fund property tax levies that would be eligible for the 41% credit are estimated to be $1,778.2 M for CY 2003. No school formula currently exists for CY 2004. Assuming a 2.7% annual increase in levies, the levies eligible for the 41% credit would be $1,826.2 M in CY 2004 and $1,875.5 M in CY 2005. School general fund credit expenditures from the Property Tax Replacement Fund for FY 2003 are estimated at about $364.5 M, ½ of the CY 2003 credit, $738.9 M for FY 2004, and $758.9 M for FY 2005.

School Transportation Fund PTRF Credit. The bill increases the current 20% state property tax replacement credit on school transportation fund levies to 50%. School transportation fund credit expenditures from the Property Tax Replacement Fund for FY 2003 are estimated at about $83.3 M, ½ of the CY 2003 credit, $171.6 M for FY 2004, and $181.9 M for FY 2005.

Budget Deficit Reduction Provisions:

School Funding Provisions: The bill appropriates $35 M for FY 2003 to the Department of Education to be distributed to local schools based on the average daily attendance (ADA) of the school corporation. The bill also automatically allots the appropriations for the Department of Education for FY 2002 and FY 2003. The bill allots about $5.2 M for FY 2002 and $30.2 M for FY 2003 that the Governor included in his Budget Deficit Management Plan as reversions.

Under this provision, the state would experience reduced expenditures by the removal of funding for ISTEP tests in social studies and science. Under the proposal, the ISTEP program would include only math and english exams after July 1, 2002. The bill would reduce expenditures in FY 2003 by at least $0.8 M and in FY 2004 by at least $0.9 M. Under P.L. 291-2001, the FY 2003 total appropriation for ISTEP+ testing and remediation (grades 3, 6, 8, and 10) is $40,174,677. Testing and remediation funding is provided from both the state General Fund and state dedicated funds.

Additionally, the bill gives the State Budget Agency the option (with the approval of the State Budget Committee) to reduce the FY 2003 appropriation for testing and remediation in P.L. 291-2001. Under the bill, the Governor may issue an executive order suspending or revising ISTEP testing and remediation in FY 2003.

Operating Expenses for Higher Education: The bill also requires a reduction of $29 M in FY 2003 appropriations for operating expenses for higher education. The bill specifies that the reduction shall be in the proportion of the operating appropriations of each campus divided by the total operating appropriations for all university campuses. The bill would allow universities to defray the operating appropriation reductions with funds appropriated to Higher Education Technology from the Build Indiana Fund. The amount available may not exceed $29 M.

This bill automatically allots $20 M of the $56.5 M appropriation to Higher Education for general repair and rehab. The State Budget Agency is to prepare and provide for the Budget Committee's review of the formula for the distribution of the allotted general repair and rehab funds. The amounts of the distribution should be proportional to the appropriations.

The bill also appropriates $10 M for FY 2003 to state universities for technology. The formula to distribute the technology funds is to be developed by the State Budget Agency and reviewed by the Budget Committee. Distribution of technology funds is only made to universities that did not increase their technology fee after March 15, 2002, or do not rescind the increase after March 15, 2002.

Indiana Commission on Health Care Excellence: The bill appropriates $100,000 over two years, FY 2002 and FY 2003, for the operation of the subcommittees of the Indiana Commission on Health Care Excellence.

Medicaid Program: The bill provides for specific changes to the Medicaid program, including: (1) authorizing OMPP to require a Medicaid recipient to select only one pharmacy; (2) repealing a statutory prohibition against implementing a rule that would limit the number of brand name drug prescriptions per month; (3) and imposing a $2 fee until August 1, 2004, on health facilities on a per bed per day basis. The impacts to the state from these changes are summarized in the following table.

Impact of Medicaid Changes on General Fund	**Total**	**State**	**Federal**
Expenditures ($M):			
Pharmacy "Lock-in"	(35.5)	(13.5)	(22.0)
Allow a Monthly Limit on Brand Name Drugs	(23.7)	(9.0)	(14.7)
$2 Bed Fee Impact on State Veterans' Home		0.2	
Revenues ($M):			
$2 Bed Fee on Nursing Facilities	62.1	23.6	38.5
Total Impact on General Fund	121.3	45.9	75.2

* The estimates of the total impact on the General Fund above represent full-year impacts. The FY 2003 impact is assumed to be 75% of the above for the pharmacy "Lock-in" and brand name drug limitation provisions due to the time required to promulgate rules. The FY 2003 impact for the Nursing Facility Bed Fee is assumed to be about 92% because of the effective date for collection of the fee.

PTRC Distributions: The state currently makes six Property Tax Replacement Credit distributions to county treasurers each calendar year from the Property Tax Replacement Fund (PTRF). Under HEA 1001 (2001), the May 2001 distribution was delayed until July 2001. After 2001, the original payment schedule is to be resumed. This means that the last FY 2001 payment was delayed until FY 2002, thereby creating five payments in FY 2001 and seven payments in FY 2002. This bill would require that the alternative schedule is to be used each year. The continued delay of the May payment until July would reduce the number of payments in FY 2002 from seven to six and reduce state expenditures from the PTRF by about $154 M in FY 2002.

State Facilities Down-Sizing Provisions:

This bill has certain provisions regarding the downsizing or closure of facilities under the control of the Family and Social Services Administration. The Division of Mental Health and Addiction may not terminate, in whole or in part, normal patient care or other operations at any institution operated by the Division without the specific statutory authority of the General Assembly. The Division is prohibited from reducing staffing levels at any operating facilities below those in effect on January 1, 2002. Further, the Division may not remove, transfer, or discharge any patient unless it is in the patient's best interest. In addition, this bill contains provisions for the Division of Disability, Aging, and Rehabilitative Services.

Division of Disability, Aging, and Rehabilitative Services - Muscatatuck State Developmental Center Closure - **Cost** - variable depending upon placement of patients in the community - upper end estimate of $51.7 M annually.

This facility is scheduled for closure by June 2003. This bill states that this facility may not close unless specifically authorized by statute. Thus, the facility is required to remain open indefinitely. In addition, the Division needs the express written consent of a patient's guardian or representative for the patient's removal, transfer, or discharge. There are currently 837 full-time state and 178 full-time contract employees at this facility. As of May 13, 2002, there were 200 patients at Muscatatuck.

Extension of Muscatatuck Closure Date: This bill extends the closure date of Muscatatuck State Developmental Center (MSDC) indefinitely. The MSDC is currently budgeted through June 30, 2003.

The estimated budget for MSDC is currently $51.7 M (all numbers are current as of May 13, 2002). The per diem for residents at MSDC is currently $708 per resident. Of this amount, Medicaid reimburses the state $265, with state cost of $443 per resident. (The maximum Medicaid allowable per diem is $428 per resident. This amount includes the state share of $163. Since the MSDC per diem is above this match, the state is responsible for 100% of costs above this amount, or an additional $280).

The cost of this provision depends upon the number of residents remaining at MSDC in 2004. Many of the residents are in the process of transferring to placements in the community. Of the 200 remaining residents, 132 have "support plans" that identify the needs required for a patient's placement in the community, and 106 guardians have signed medical consent release forms. Depending on the timing of the transition process, some residents may be in a community placement by the end of FY 2003. Given this possibility, the costs associated with keeping MSDC open are difficult to assess. However, the fixed costs are $300,000 and costs per resident are $20,029 per month.

Capital Costs: The FSSA hired BSA Design to review the condition of state-operated care facilities. This study estimates that MSDC requires $84.1 M in capital improvements over the next ten-year period to maintain existing service. The immediacy of these repairs is not known, however, the Division has continued to make repairs to the facility to maintain a safe, livable environment. The extent and cost of critical repairs are not known at this time.

Expenditures from the Motor Vehicle Highway Account: The bill changes the funding sources for the State Police operating account. Currently, the State Police operating account is funded from the State General Fund, the Motor Vehicle Highway Account (MVHA), and the Motor Carrier Regulation Fund. The bill funds the State Police operating account from the MVHA and the Motor Carrier Regulation Fund. This will reduce State General Fund expenditures by an estimated $54,841,661 for FY 2003. The bill does not change the funding for the State Police Pension and Benefit Funds which are supported equally by the State General Fund and the MVHA.

The MVHA also distributes funds to the Department of Transportation and local units of government based on a formula. The additional MVHA funds used to support the State Police would otherwise have been distributed with 53%, or approximately $29,066,080, going to the Department of Transportation, and 47%, or approximately $25,775,581, going to local units of government.

The bill adjusts MVHA distributions by removing $20 M of MVHA funds from the Personal Services account of the Bureau of Motor Vehicles (BMV) and distributing these funds based on a formula which provides 53%, or $10.6 M, to the Department of Transportation, and 47%, or approximately $9.4 M, to local units of government. The $20 M of MVHA funds which the BMV loses may be replaced with additional revenue generated by fees charged in license branches.

The bill provides that $34.842 M that would otherwise be distributed to the State Highway Fund (INDOT), are to be used to fund the appropriation for the State Police. The bill provides that distributions to local units will not be reduced from what they would otherwise receive. The State Auditor will compute what local units would have received prior to the bill and will reduce INDOT's distributions and increase local units' distributions to provide that amount. The net effect of the proposed changes will ultimately impact the INDOT and not local units.

Tobacco Farmers Provisions: The bill annually appropriates money from the General Fund to the Value Added Research Fund, the Rural Development Administration Fund, and the Indiana Rural Development Council. (See the table below.) The funds are established as non-reverting; the appropriation to the Value Added Research Fund is made in addition to the existing level of appropriation.

General Fund Impact	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Value Added Research Fund	$1.0 M	$1.0 M	$1.0 M	$1.0 M	$1.0 M	$1.0 M	$1.0 M
Rural Develop. Admin. Fund	2.5 M	2.5 M	2.5 M	2.5 M	2.5 M	2.5 M	2.5 M
Rural Development Council	1.2 M	1.2 M	1.2 M	1.2 M	1.2 M	1.2 M	1.2 M
General Fund Appropriations	$4.7 M	$4.7 M	$4.7 M	$4.7 M	$4.7 M	$4.7 M	$4.7 M

The Tobacco Farmers and Rural Community Trust Fund is renamed the Tobacco Farmers Fund. The bill requires certain transfers of revenue from the Tobacco Master Settlement Agreement Fund to the Tobacco Farmers Fund until January 1, 2010. (See the table below.) The estimated payments to the Tobacco Master Settlement Fund will be sufficient to make the required transfers to the Tobacco Farmers Fund. The bill also repeals the FY 2003 appropriation of $5 M for the Tobacco Farmers and Rural Community Trust Fund from the Tobacco Master Settlement Agreement Fund. It further requires that any remaining funds from the FY 2002 appropriation be returned to the Tobacco Master Settlement Agreement Fund.

Tobacco Master Settlement Fund Impact	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Phase II Supplement ($23.6M)	$4.72 M	$4.72 M	$4.72 M	$4.72 M	$4.72 M		
Phase II Market Share Adjust.	0.63 M	0.64 M	0.65 M	0.66 M	0.67 M	0.68 M	0.69 M
Tobacco Master Settlement	$5.35 M	$5.36 M	$5.37 M	$5.38 M	$5.39 M	$0.68 M	$0.69 M

Expenditure Limits: This bill establishes a maximum annual percentage change for state government expenditures to be based on the lesser of the three-year average change in Indiana non-farm personal income over the prior three fiscal years or 6%. The bill excludes expenditures for education, teachers' pension obligations, Medicaid, and property tax replacement from the expenditure limits. If revenues exceed the expenditure limit, the excess shall be deposited in the Excess Tax Fund. The General Assembly may authorize spending that exceeds the expenditure limit if a concurrent resolution is adopted by a majority of the members of both the House and Senate.

The bill allows individuals to file a lawsuit to enforce the state expenditure limits. Successful plaintiffs are allowed costs and reasonable attorney fees. The state may recover costs and reasonable attorney fees if a suit is ruled frivolous.

This bill applies to appropriations beginning in FY 2004. According to the November 14, 2001, Surplus Statement, FY 2003 budgeted appropriations are $10,497.9 M and net expenditures are estimated to be $10,488.9 M. The average annual change in Indiana non-farm personal income for the last three years (FY 1999 to FY 2001) has been 3.9%.

The impact on state spending and the amount of revenue which would be available for refund is subject to legislative, executive, and judicial actions.

Background Information: The prior three-year average annual change in the Indiana non-farm personal income and population for the last three fiscal years, as well as the maximum limits set out in this bill, are identified below.

Fiscal Year	3 Year Avg % Change in IN Non-Farm Income
1999	3.8%
2000	3.9%
2001	3.9%

Earned Income Tax Credit Refunds: The refundable portion of the earned income tax credit (EITC) qualifies as Maintenance of Effort (MOE) expenditures and would contribute toward the state's annual MOE requirement under the Temporary Assistance to Needy Families (TANF) program. Based on simulations using 1999 tax return data, EITC refunds for those eligible under current law total an estimated $13.8 M. The simulations also suggest that refunds under the bill would total about 30% of total credits. Thus, the refundable EITC would increase by about $2 M to $2.5 M.

Indiana Gaming Commission: The bill requires the Indiana Gaming Commission (IGC) to regulate and administer pari-mutuel pull tab operations. The IGC would incur additional administrative expenses as a result. However, the bill requires that the holder of a pull tab license or supplier's license bear the cost of any investigation by the IGC relating to the licensee. Also, the bill allows the IGC to impose an administrative fee on race track or satellite facility permit holders offering pull tab games in an amount that allows the IGC to recover the costs of administering pari-mutuel pull tabs.

The IGC also would incur additional administrative expenses relating to the licensing and regulation of gaming at the Orange County riverboat casino. As with the existing riverboat casinos, such administrative costs will be covered with revenue from license fees and the Riverboat Wagering Tax.

Purchasing Goals: The bill establishes minority and women's business purchasing goals for horse racing track and satellite facility owners selling pari-mutuel pull tabs. It places responsibility for enforcement of these requirements under the IGC. Currently, the IGC administers similar requirements for riverboats. The bill also establishes the Minority and Women Business Participation Fund to be administered by the IGC. Under the bill, the Fund contains fines for violations of the minority and women business purchasing requirements and an annual fee of $10,000 imposed on each riverboat and each racetrack or satellite facility selling pull tabs. The Department of Administration may use fee money in the Fund to hire employees to administer the purchasing goals program. Otherwise, the money in the Fund is to be used to assist women and minority business enterprises. Expenses of administering the Fund must be paid from money in the Fund.

Minority Health Initiatives Fund: The Minority Health Initiatives Fund is established to provide funding for the Minority Health Coalition to implement the Minority Health Initiative Program. The fund is non-reverting and annually appropriated; it consists of distributions from the Cigarette Tax, appropriations from the General Fund, and from any other source. The fund is estimated to receive distributions from Cigarette Tax revenue of $405,000 in FY 2003, $422,000 in FY 2004, and $425,000 in FY 2005.

Income Tax Deductions and Credits: The Department of State Revenue (DOR) will incur some administrative expenses related to the revision of tax forms, instructions, and computer programs due to the temporary suspension of the homeowner's property tax deduction, the temporary re-institution of the property tax add back, and various tax credits in the bill. These expenses presumably can be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues:

Tax Restructuring Provisions:

Personal Property Tax Credit: This bill would repeal the existing $37,500 AV credit against state tax liability for personal property (PPTRC). The cost of the credit under current law is estimated at $96.0 M in FY 2004 and $97.9 M in FY 2005. The state would not experience this revenue reduction under the proposal.

Corporate Taxes: This bill eliminates the Gross Income Tax, except for utilities, and the Supplemental Net Income Tax and establishes a Corporate Adjusted Gross Income Tax at a rate of 8.5% applied to apportioned Indiana AGI.

This bill eliminates the Indiana Corporate Gross Income Tax, IC 6-2.1, as of December 31, 2002, for all businesses except public utilities. Taxpayers filing on a calendar year basis will end their year and pay the final payment on April 15, 2003. Fiscal year Corporate Gross Income Tax filers will also end their year on December 31, 2002, and make a payment for the shortened tax year on April 15, 2003. They may then begin a new shortened year in 2003 to re-establish their fiscal year for tax purposes.

Background: Currently the Corporate Gross Income Tax applies to regular corporations who must compute their gross tax liability and their adjusted gross tax liability and pay the greater of the two. A corporation must then subtract that liability from apportioned Indiana Adjusted Gross Income (AGI) and pay Supplemental Net Income Tax (SNIT) at a rate of 4.5% on that tax base. The effective tax rate for a taxpayer paying Adjusted Gross Income Tax and Supplemental Net Income Tax is 7.747%.

Methodology: The impact of eliminating the Gross Income Tax is estimated by calculating Indiana Corporate AGI from Supplemental Net Income Tax payments. (These estimates have been adjusted for the change in the treatment of public utilities which are referenced below.) By applying the effective rate of 7.747% to the Indiana apportioned AGI tax base and subtracting total corporate tax receipts as defined under current law for a given year, the effect of the Gross Income Tax on Indiana's corporate income tax revenue is isolated. The estimate of revenue lost in FY 2003, one-half the annual total for that year, is $81.68 M, $168.2 M in FY 2004 and $173.2 M in FY 2005.

The increased tax rate, from an effective rate of 7.747% to 8.5%, on apportioned Indiana AGI applies for taxable years beginning after December 31, 2002. Therefore, it would take effect mid-way through state FY 2003. If corporations adjusted tax payments immediately, the impact is estimated to be an additional $37.2 M in FY 2003. It is likely that taxpayers will not adjust on time and that most taxpayers will not remit the full amount for the higher rate until filing after the end of their fiscal year. In that case most or all of the $37.2 M will be shifted into FY 2004. Adjusted Gross Income Tax revenue collections would increase by an additional $76.6 M in FY 2004 and $78.9 M in FY 2005.

Taxation of Public Utilities Income: This bill increases the corporate Gross Income Tax rate on gross receipts of utilities from 1.2% to 1.6% and eliminates the Gross Income Tax as a credit against their Adjusted Gross Income Tax liability. Therefore utilities will effectively be paying both the Gross and Adjusted Gross Income taxes. Utilities would no longer pay the SNIT and would not be subject to the Business Supplemental Tax. The interaction of these tax changes will effectively increase revenue from public utilities by approximately

$99 M in CY 2003. Based on estimated payments, an additional $ 49.5 M would be generated in FY 2003, $101.97 M in FY 2004, and $105 M in FY 2005.

Business Supplemental Tax: This bill also imposes a Business Supplemental Tax (BST) based on adjusted gross income (AGI) of all legal entities doing business in Indiana. The term “legal entities” for tax purposes excludes sole proprietorships. Utilities are exempt from this fee. The fee is imposed at a rate of 1.9% on AGI. There is a minimum tax of $100.

Methodology: The estimate of revenue received from a Business Supplemental Tax is based on data from the Department of State Revenue corporate tax returns and the federal Internal Revenue Service individual income tax returns for Indiana. (The bill potentially allows some businesses to take a credit against the BST for ICHIA assessments so this estimate has been adjusted accordingly.) This methodology yields a forecast of $217.8 M for CY 2003, which is estimated to grow at the same rate as other business income, 3% per year.

Taxpayers are to remit this fee during the fourth month after their tax year begins. Approximately 60% of corporate tax payers file on a calendar year basis. Therefore, it is estimated that approximately $87.1 M will be remitted in FY 2003, $220.4 M in FY 2004 and $227.0 M in FY 2005.

Investment Tax Credit for New Personal Property: This provision creates an income tax credit available for owners of new business personal property. The property would have to be a newly purchased depreciable asset, be used in the production of income, and have a useful life of at least three years. The income tax credit would equal 15% of the net property tax paid on the property in its first taxable year and 10% of the net property tax paid on the property in its second taxable year.

The income tax credit may be taken against the taxpayer's liability under the Corporate Gross Income Tax, Corporate Adjusted Gross Income Tax, Financial Institutions Tax, and Insurance Premiums Tax. If the amount of the credit exceeds the taxpayer's liability, the taxpayer would be entitled to a refund. The Investment Tax Credit would reduce state revenues.

The credit would first be claimed for tax years beginning 2003. Adjusting for estimated quarterly payments, revenue collections would be impacted beginning in FY 2003 with the full cost of the credit beginning in FY 2004. The cost of the credit is estimated in the following table.

Investment Tax Credit State Revenue Reduction Estimate			
Tax Year	**Credit Amount**	**Fiscal Year**	**Credit Amount**
2003	$ 60.0 M	FY 2003	$ 30.0 M
2004	58.0 M	FY 2004	59.0 M
2005	56.2 M	FY 2005	57.1 M

The Investment Tax Credit would not be available for property on which the taxpayer received a Capital Investment Tax Credit (in Shelby County) or a Rerefined Lubrication Oil Facility Credit.

Research Expense Credit: This bill eliminates the apportionment factor for the Research Expense Credit and increases the credit from 5% to 10% for tax years beginning January 1, 2003. It is currently set to expire December 31, 2002. This bill also makes the credit permanent. It is estimated that these changes will result in a revenue loss of approximately $23 M in FY 2003 (due to changes in estimated quarterly payments), $47.9 M in FY 2004, to $51.5M in FY 2005.

Over the past four years, the current Research Expense Credit has ranged from $9.2 M in FY 1996 to $24.2 M in FY 1999. It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability.

Apportionment Provision: This modification would mean that the credit is based on the taxpayer's Indiana qualified research expenses, rather than the lesser of its Indiana qualified research expenses or its apportioned research expenses for the tax year beginning January 1, 2004. Currently, only businesses that do not have income apportioned to the state for a taxable year may calculate their credit based on only Indiana research expenses.

This change would lower the tax liability for multi-state, Indiana-domiciled companies that conduct a significant proportion of their research in Indiana, compared to the research conducted through their non-Indiana operations. Elimination of the apportionment factor will allow all companies to compute their tax credit based on the amount of research actually conducted in the state. It is unknown how many Indiana businesses would be affected by this change.

Rate Change: The bill also increases the percentage of credit which may be taken for research and development activities from 5% to 10%.

Elimination of Expiration Date: This bill also eliminates the December 31, 2003, expiration date for the current credit and effectively makes this a permanent credit available to taxpayers.

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

Research expense tax credit affects revenue collections deposited in the General Fund.

Increase in Renter's Deduction: The bill increases the renter's deduction from $2,000 to $4,000 beginning in tax year 2003. The revenue loss from this change is estimated to total $43.6 M in FY 2004 and $44.4 M in FY 2005. Under current law, a taxpayer may deduct from his or her state taxable income an amount equal to the total rent paid during a tax year up to $2,000. The rent deducted must be paid on the taxpayer's principal place of residence. In 1999, 637,500 taxpayers deducted rent totaling approximately $1,187.9 M under the renter's deduction. The estimated impacts are based on the 1999 deduction total inflated to account for trends before 1999 in the average deduction amount and number of taxpayers claiming the deduction.

Sales & Use Tax: This bill increases the Sales and Use Tax from 5% to 6% effective December 1, 2002. The bill also makes changes in the manner in which Sales and Use Tax revenue is distributed. The bill changes the distribution of the revenue so that revenue generated as a result of the tax increase is deposited into the Property Tax Replacement Fund.

The increase is expected to generate approximately $393.0 M in FY 2003, $806.4 M in FY 2004, and $827.3 M in FY 2005 in increased Sales Tax Revenue. This estimate assumes that the Sales Tax revenue will grow 2.6% over FY 2003, FY 2004, FY 2005. (This is the same rate forecast for FY 2002 by the Revenue Technical Committee on November 14, 2001.)

The bill also changes the distribution of Sales Tax revenue so that the funding levels of the Public Mass Transportation Fund, the Commuter Rail Service Fund, and the Industrial Rail Service Fund will remain at their current levels.

Assessment of Rental Housing: The State levies a small tax rate for State Fair and State Forestry. A $50 M reduction in the assessed value base will reduce the property tax revenue for these two funds by about $1,650 annually.

New Fund: The bill also establishes the Tax Relief Fund. The Tax Relief Fund is established to provide a source of money to maintain the homestead credits, property tax replacement credits, and inventory tax replacement to meet the state's obligations when economic conditions result in lower General Fund revenue collections. This fund is to be administered by the State Treasurer. Interest that accrues to this fund will remain in the fund. Money in the fund at the end of the fiscal year does not revert to the General Fund. The Budget Director shall determine the unused 21st Century Tax Plan balance to be transferred into this fund.

Based on the above estimates, it is anticipated that approximately $8.3 M could be transferred to the Tax Relief Fund in FY 2003.

Budget Deficit Reduction Provisions:

Withholding on Gambling Winnings: The bill requires riverboat casino owners to deduct and retain income tax on gambling winnings if the net amount or value paid, after deducting the amount wagered, is at least $600. The bill requires withholding even if federal tax withholding is not required. The bill requires payment of withholdings on a next (business) day basis. This requirement is estimated to generate about $15 M in income tax from nonresidents gambling at Indiana riverboats. This estimate is based on Department of Revenue (DOR) data from federal withholding statements for gambling winnings. The statements were filed by Indiana riverboats during 1999 and 2000 for nonresident gamblers winning at least $600.

Note: The revenue impact of the bill could be reduced since it requires withholding when the net winnings (winnings - wager) are at least $600. According to the DOR the federal reports are based on gross winnings of $600 or more. However, the revenue impact also could be increased as the bill may require withholding on some gambling winnings that are not reported for federal tax purposes. Such winnings would not be reflected in the federal reports data.

Riverboat Gaming: The bill makes several changes that will affect revenue and distributions from taxes on riverboat casinos.

(1) The bill permits a riverboat owner to commence flexible boarding operations allowing for continuous boarding of riverboat patrons. The change to flexible boarding is expected to increase both wagering and admissions on riverboats and, thus, is expected to increase revenue from the Riverboat Wagering Tax.

(2) The bill imposes a graduated Wagering Tax on adjusted gross wagering receipts (AGR) (total wagers

minus winnings paid to bettors and uncollectible receivables). The tax is 28% on the first $100 M in annual AGR and 31% on annual AGR exceeding $100 M.

(3) The bill eliminates the Admission Tax and replaces state and local distributions from this tax with revenue from the Wagering Tax. The bill establishes annual replacement distributions from Wagering Tax revenue totaling $250 M for the Build Indiana Fund (BIF); $26 M for the Horse Racing Commission; $4 M for the state Mental Health Division; and $6 M for the State Fair Commission.

(4) The bill also establishes additional annual wagering tax distributions totaling $1.5 M to the "Barn" and $1 M each to the School for the Deaf and School for the Blind beginning in FY 2003; and $3.5 M in FY 2004 and $7 M beginning in FY 2005 to the Shoreline Environmental Trust Fund.

The estimated impact of these changes are presented in the table below. This assumes that all of the existing riverboats will begin dockside gaming operations beginning in July 2002. The earmarks specified above in (3) and (4) are funded from base Wagering Tax revenue beginning in FY 2005. In FY 2003 and FY 2004, respectively, $11.9 M and $5.7 M in new revenue are utilized for these distributions. **In FY 2005 base Wagering Tax revenue will exceed the amount required for the earmarks by about $895,000. This money will be distributed to the state General Fund. Thus, the total General Fund impact of these changes is approximately $278.6 M in FY 2005.**

	FY 2003	**FY 2004**	**FY 2005**
Total New Revenue	345.7 M	357.8 M	370.3 M
State Share (75%)	259.3 M	268.4 M	277.7 M
Amount of New Revenue Distributed to State GF	247.4 M	262.7 M	277.7 M
Base Revenue Shift to GF			0.895 M
Local Share (25%)	86.4 M	89.4 M	92.6 M

Pari-mutuel Pull Tabs: The bill authorizes the sale of pari-mutuel pull tabs at Hoosier Park, the Marion County satellite facility operated by Hoosier Park, Indianapolis Downs (to be located in Shelby County), and a Marion County satellite facility operated by Indianapolis Downs. The bill limits the number of electronic pull tab terminals or devices that may be installed to 700 per facility.

<u>Wagering Tax:</u> The bill imposes a graduated Wagering Tax on pari-mutuel permit holders selling pull tabs at racetracks or satellite facilities. The tax is imposed on the permit holder's combined adjusted gross wagering receipts (AGR) from pull tab sales. The tax is 32.5% on the first $150 M in annual AGR and 37.5% on annual AGR exceeding $150 M. Annual revenue from the tax on pull tab sales at Hoosier Park and the Marion County satellite facility operated by Hoosier Park could potentially total $44.7 M annually beginning in FY 2004. Under the bill, 70% of this revenue would be distributed to state. The first $26 M annually would be distributed to the Horse Racing Commission for support and operation of horsemen's associations and for promotion and operation of horse racing. The remainder would be distributed to the state General Fund. This distribution is estimated to total about $5.3 M annually. These estimates are based on actual admissions, and admissions estimates derived from betting handles at Hoosier Park and existing satellite facilities. Since admissions and betting handle for Indianapolis Downs is unknown at this time, no

estimates are provided for the impact of pull tab sales at its facilities.

County Revenue Sharing: The annual distribution of Pull Tab Wagering Tax revenue to the Horse Racing Commission would replace Riverboat Wagering Tax revenue otherwise distributed to the Commission. The distribution from the Riverboat Tax is set at $26 M annually. Annually, the Riverboat Tax revenue that is replaced would be distributed based on population to the counties that do not have a riverboat, horse racetrack, or satellite facility selling pari-mutuel pull tabs. Cities and towns would receive a pro rata share of each county's money based on population.

Purse Money/Breed Development Fee: The bill imposes a Purse Money and Breed Development Fee on pari-mutuel permit holders who sell pull tabs. The fee would be imposed on the "net receipts" from such sales defined as the adjusted gross receipts from pull tab sales minus the amount paid in wagering tax on pull tabs. The fee would be imposed as specified in the table below beginning the third year in which the permit holder sells pull tabs. Revenue from the fee would be distributed to the Horse Racing Commission for purses and breed development. The revenue impact is based on potential pull tab receipts at Hoosier Park and its Marion County satellite facility.

Year of Selling Pull Tabs	**Fee**	**Revenue ($)**
3rd year	2%	$1.9 M
4th year	2%	$1.9 M
5th year	5%	$4.6 M
6th year	7%	$6.5 M
7th year	8%	$7.4 M
8th year	9%	$8.4 M
9th year	10%	$9.3 M
10th year and each year thereafter	12%	$11.1 M

Annual Supplemental Fee: The bill requires the Horse Racing Commission to impose an annual fee of $250,000 on each horse racetrack owner. The fee paid by Hoosier Park is to be used for training facilities and capital improvements, including stall improvements. The fee paid by Indianapolis Downs is to be used to promote live racing at county and 4-H fairgrounds.

License Fees: The bill provides for a pari-mutuel pull tab license and a pari-mutuel pull tabs supplier's license. The initial pull tab license would be effective for 5 years. The annual renewal fee would be determined by the Indiana Gaming Commission. The annual fee for a supplier's license would be $5,000. The bill requires a person to obtain a supplier's license to furnish pari-mutuel pull tab terminals or devices in Indiana. The license fee revenue will be minimal as there will be only two pull tabs licensees and the number of suppliers necessary to provide 2,800 pull tab terminals to four facilities is minimal.

Existing Pari-mutuel Admission Tax: Revenue from the existing $0.20 Pari-mutuel Admissions Tax could potentially increase if pari-mutuel pull tab sales serve to increase paid attendance to live horse racing at Hoosier Park. The total impact could potentially total $78,000 to $166,000 annually. Under current law, 50%, or $39,000 to $83,000, would be distributed to the state General Fund.

Orange County Riverboat: The bill would eliminate the Patoka Lake riverboat license and instead authorize licensing a casino located in Orange County within a Historic Preservation District that consists solely of the real property owned by the historic resort hotels in French Lick and West Baden. The owner's license for the casino would be issued to the Historic Preservation District operated jointly by French Lick and West Baden. The District would contract with a person holding an Operating Agent's License to operate and manage the casino. The Operating Agent's License would be issued by the Indiana Gaming Commission. The bill limits the Orange County casino to a total of 500 electronic gaming devices (EGD), with no limit placed on table games. An Orange County casino with 500 EGDs is estimated to generate about $14.0 M in additional annual revenue from the Riverboat Wagering Tax. Under the bill, 24% of the Wagering Tax revenue from the Orange County casino would be distributed to the state General Fund. This distribution is estimated to total $3.36 M annually beginning in FY 2005.

The revenue impact is based on the average Wagering Tax receipts in recent years from (1) the three smallest riverboats with respect to casino square feet and gaming positions and (2) the three riverboats having the lowest admissions totals. This average is also adjusted to account for the 500 EGD limit at the Orange County casino. The casino likely will not have an impact until late in FY 2004 or FY 2005. This conclusion is based on the start-up times for the ten existing riverboat casinos as well as the fact that the bill would require voters in French Lick and West Baden to pass a referendum allowing riverboat gambling in the county. It has taken an average of 17 months from the time the certificate of suitability was issued by the Gaming Commission for the ten existing riverboats to commence gaming operations. (The certificate of suitability is issued by the Gaming Commission to a person who has been chosen to receive a Riverboat Owner's License.)

<u>License Fees:</u> The bill also would affect revenue to the state from the Occupational License Fee and would establish an Operating Agent's License Fee. The bill excludes the Historic Preservation District from paying application and license fees relating to the Owner's License. Given that there are already a number of licensed supplier's operating in the state, supplier's licenses may not be affected by the bill. License fee revenue is distributed to the State Gaming Fund. The Occupational License Fee is imposed on individuals employed in certain riverboat gambling occupations. The Application Fee is dependent on the type of license obtained, ranging from $75 to $1,000. The Annual License Fee is also dependent on the type of license obtained, ranging from $25 to $100. Revenue from the Application Fee totaled approximately $1.26 M in FY 2001; and revenue from the Annual License totaled $202,975 in FY 2001. There would be one operating agent licensed for the Orange County casino. The bill requires an application fee to be determined by the Gaming Commission for an Operating Agent's License. The initial license fee for an operating agent is $25,000, with an annual renewal fee of $5,000.

Suspension of Homeowner's Property Tax Deduction: The bill suspends the homeowner's property tax deduction during tax year 2002. The revenue gain from this temporary change is estimated to total $56 M in FY 2003. Under current statute, a taxpayer may deduct property taxes paid during the taxable year in Indiana on his or her principal place of residence. The deduction is limited to the lesser of the property taxes paid or $2,500. In 1999, about 1.16 M taxpayers claimed this deduction resulting in a revenue loss of approximately $39.9 M. The estimate is based on: (1) the 1999 total adjusted for recent growth in property taxes and taxpayers claiming the renter's deduction; and (2) the maximum potential deduction based on the statewide residential property tax levy.

Re-institution of Property Tax Add Back: The bill re-institutes the property tax add back for tax years 2002, 2003, and 2004. The revenue gain from this temporary change is estimated to total $91.7 M in FY 2003, $77.8 M in FY 2004, and $76.4 M in FY 2005. Prior to tax year 1999, business property taxes deducted for federal tax purposes were added back on Corporate and Individual Income Tax returns; and financial institution property taxes were added back on Financial Institutions Tax returns. The estimate is based on: (1) prior simulation estimates of the property tax add back on Corporate and Financial Institutions returns that incorporates an estimate of the add back on Individual Income Tax returns based on 1998 and 1999 tax year data; and (2) prior estimates based on corporate and financial institutions simulations and individual return data. The latter are currently utilized for purposes of adjusting income tax forecasts. The estimates for FY 2004 and FY 2005 reflect percentage reductions in business property taxes under this bill.

Tobacco Funds: The bill appropriates funds from the investment trust portion of the Tobacco Master Settlement Agreement Fund for the Office of Medicaid Policy and Planning. The money appropriated is to be used to meet Medicaid expenditure obligations due to court settlements. The transfer and expenditure of the funds are subject to Budget Agency approval and the review of the State Budget Committee. The level of funding required is not included in the Medicaid budget and is contingent upon the ultimate size of the class eligible to participate in the court settlement and the extent to which individuals incurred actual expense.

Expansion of Earned Income Tax Credit: The bill eliminates the current Earned Income Tax Credit (EITC) and establishes a credit equal to 8% of the federal Earned Income Credit beginning in tax year 2003. The current EITC is scheduled to sunset after tax year 2003. The bill is estimated to increase the cost of the EITC above the current base cost of the credit by approximately $14.0 M in FY 2003, $34.3 M in FY 2004, and $36.2 M in FY 2005.

Federal income tax data for tax year 1999 indicates that the federal credit was claimed on 356,503 income tax returns filed by Indiana residents. These credits totaled $556.6 M. The estimates are based on the 1999 total inflated by 3.5% to reflect recent annual growth in the credit total. The net revenue loss assumes a base cost equal to $17.5 M for the current EITC. Data from 1999 state income tax records indicates that approximately 105,000 taxpayers were eligible to claim the EITC under current law. The credit amount available to these taxpayers is estimated to total $17.5 M. The FY 2003 total assumes that the change to the EITC will affect monthly withholding during the second half of the fiscal year.

Cigarette Taxes: This bill increases the Cigarette Tax on packs of 20 cigarettes to $0.55 from the current rate of $0.155 and adjusts the statutory percentage distribution of Cigarette Tax revenue. Based on data from the *November 14, 2001, Revenue Forecast Update*, the proposed Cigarette Tax rate and distributional changes will generate an additional $3.9 M in FY 2002, $272.6 M in FY 2003, $294.7 M in FY 2004, and $296.4 M in FY 2005. The additional revenue is to be deposited into the Property Tax Replacement Fund.

Although the effective date of the tax increase in this proposal is July 1, 2002, the distribution changes of Cigarette Tax revenue become effective on June 1, 2002. Beginning in August 2002 when the new higher rate Cigarette Tax collections begin to be distributed, the distribution changes in the bill are expected to maintain funding of the Mental Health Centers Fund, the Cigarette Tax Fund, and the Pension Relief Fund at approximately their current levels. However, because of the differences in the timing of the tax increase and the distribution changes, the following funds will be negatively impacted in FY 2002 and FY 2003.

	FY 2002	FY 2003
Cigarette Tax Fund	(1.6 M)	(1.7 M)
Mental Health Centers Fund	(0.2 M)	(0.2 M)
Pension Relief Fund	(2.1 M)	(2.1 M)

Premium Tax: This bill delays the current reduction in the Premium Tax charged on certain insurance policies written in Indiana. The delay in the reduction is estimated to increase state General Fund revenue by $3.9 M in FY 2003, $11.7 M in FY 2004, and $11.3 M in FY 2005. The table below shows the Premium Tax rate in place under current law and with the changes proposed in this bill.

Calendar Year	Current Rate	Proposed Rate
2003	1.7 %	1.8 %
2004	1.5 %	1.8 %
2005	1.3 %	1.7 %
2006	1.3 %	1.5 %
2007 and after	1.3 %	1.3 %

Fee Changes

Property Tax Representative Licensing Fee: Under current law, the Department of Local Government Finance (DLGF) must adopt rules that govern the practice of tax representatives before the Indiana Board and the DLGF. As part of those rules, this bill would require the DLGF to establish a licensing program for tax representatives. A license applicant or license holder would be required to pay a $50 annual fee which would be deposited into the state General Fund. The license and the associated fee would not apply to the property owner, full-time employees of the property owner, representatives of local taxing units, CPAs, or attorneys.

According to the State Tax Board, there are currently between 500 and 1,000 tax representatives in the state who would be subject to the license program. The $50 annual license fee imposed by this provision would generate approximately $25,000 to $50,000 annually beginning in FY 2003.

Non-Governmental Employee Continuing Education Fee: Under current law, the DLGF must conduct a minimum of four continuing education sessions each year for the benefit of local assessing officials. This bill would require an individual who is not a local assessing official or their employee or an employee of the DLGF who attends a session to pay a fee. The fee would equal $50 for a half-day session or $100 for a full day. According to the State Tax Board, an average of 57 non-government individuals attend each of the four full-day sessions annually. Assuming continued attendance, the fee imposed under this provision would generate about $23,000 per year from these individuals beginning in FY 2003.

IDEM Fees: This bill allows the Air Pollution Control Board, Water Pollution Control Board, and Solid Waste Management Board to establish annual fees for active water system permits, municipal separate storm sewer system permits, and National Pollutant Discharge Elimination System (NPDES) general permits effective January 1, 2003. Fees for such permits and any delinquency charges for nonpayment are payable to IDEM for deposit in the Environmental Management Permit Operation Fund. The bill increases the annual permit fees for various NPDES permits. It also increases the following solid waste fees: (1) application fees for solid waste permits; (2) annual operation fees; and (3) disposal fees. The bill also increases the following hazardous waste fees: (1) application fees for hazardous waste permits, and (2) annual operation fees.

Wastewater, solid waste, and hazardous waste fees are increased by 20%. An amount equal to 91.666% of the fee revenue for fees generated under IC 13-18-20 (wastewater), IC 13-20-21 (solid waste), and IC 13-22-12 (hazardous waste) are to be deposited into the Environmental Management Permit Operation Fund and 8.334% are to be deposited in the State General Fund. However, for the period beginning July 1, 2001, and ending June 30, 2003, all fee increases (for a six-month period from January 1, 2003 (applying the effective date), to June 30, 2003) must be used exclusively for total operating expenses of the Indiana Department of Environmental Management.

The wastewater, solid waste, and hazardous waste permit application and annual operation fee revenue increase estimates are as follows:

* Wastewater: $0.367 M annually to IDEM, and $0.367 M to the General Fund.
* Solid Waste: $0.3 M annually to IDEM, and $0.3 M annually to the General Fund.
* Hazardous Waste: $0.167 M annually to IDEM, and $0.167 M to the General Fund.

The above estimates are based on 20% increase to the FY 2000 fee collections in those programs. The bill increases the amount to be collected by approximately $834,000. In addition, approximately $834,000 will now go the State General Fund as a result of the provision which would deposit 8.334% into the State General Fund except for the six-month period beginning January 1, 2003, and ending June 30, 2003. Fees collected during this period, an estimated $417,000, could be used by IDEM for operating expenses.

Another provision of the bill directs the fee revenue generated under IC 13-16-1-8 (new fees for public water systems, stormwater permits, and NPDES general permits) to be deposited as follows: 50% in the Environmental Management Permit Operation Fund and 50% in the State General Fund.

The fee schedule for public water supplies authorized by this bill can generate no more than $2 M annually. Of this amount, 50% would go to the State General Fund. The net impact is a reduction of approximately $1 M for IDEM.

The new stormwater fee schedule authorized by this bill can generate no more than $0.5 M annually. Of this amount 50% will go to the State General Fund. The net impact is a reduction of approximately $0.250 M for IDEM.

The proposal adds several provisions to allow money in the Underground Petroleum Storage Tank Excess Liability Trust Fund (ELTF) to be used to pay the expenses incurred in operating and administering the motor vehicle inspection and maintenance program. The expenses are currently paid from the General Fund, so there will not be a fiscal impact upon IDEM. However, it does help the State's General fund as it would provide $7.534 M in reversions to the State General Fund.

State Police Fees: (A) For supplying copies of accident reports, the State Police Department currently charges $3 for each report. The bill provides that the Department may, by rule, charge a fee in an amount greater than $3 for each report. This fee is deposited in the "accident report account." The fee generated about $108,000 under the current fee structure in FY 2001. (B) Under IC 20-9.1-4-5, the State Police Department is required to inspect all special purpose and public and private school buses that transport its pupils. The bill authorizes the State Police Department to impose fees for those inspections. In FY 2000, the Department completed 13,947 school bus inspections, 2,121 random or spot inspections, and 647 twelve-year-old or older school bus inspections. In addition, the Department made 450 to 500 special purpose bus inspections. This bill authorizes the State Police Department to impose fees for these inspections. (C) Current statute also provides for the collection of a $3 fee to defray the cost of processing a request for inspection of a limited criminal history and $7 to defray the cost of processing a request for release of a limited criminal history. This bill allows the State Police to increase the level of fees by rule. This fee generated about $1.753 M in FY 2001 under the current fee structure. The State Police conducted 265,124 limited criminal history checks in 2001. The additional revenues from these provisions will depend upon administrative action.

This bill waives the fee for the parent locator service of the Child Support Bureau of the Division of Family and Children. The State Police are not able to segregate the number of limited criminal history checks performed for the parent locator service. However, staff in the Child Support Bureau indicate it rarely, if ever, requests limited criminal history checks. The reduction in revenue due to this provision is expected to be minimal.

Funding for the Minority Health Initiatives Fund: The bill also shifts 0.1% of the total revenue generated from the Cigarette Tax to the Minority Health Initiatives Fund created by this bill. Based on data from the *November 14, 2001, Revenue Forecast Update*, this provision will provide the fund with approximately $405,000 in FY 2003 and $422,000 in FY 2004.

Explanation of Local Expenditures:

Budget Deficit Reduction Provisions:

Orange County Riverboat: The bill would prohibit the Indiana Gaming Commission from issuing an Owner's License for an Orange County riverboat until voters in French Lick and West Baden pass a referendum allowing riverboat gambling in the county. The bill contains provisions allowing the referendum to be held at a primary, general, or special election.

The bill would require the Orange County riverboat casino to be owned by and located in a historic preservation district that consists of the real property owned by the historic resort hotels in French Lick and West Baden. The District would be established under an interlocal agreement between French Lick and West Baden and would be required to contract with a person to operate the riverboat casino. The bill would require the Commission to hold public meetings and to keep a public record of its resolutions, proceedings, and actions. The Commission would be subject to laws relating to the deposit of public money and would have to deposit money under the advisory supervision of the State Board of Finance. The Commission also would be subject to examination by the State Board of Accounts. The bill establishes the French Lick and West Baden Community Trust Fund. The bill requires the net income derived from the riverboat after all operating expenses to be deposited in the Fund. The bill requires that the Commission manage and develop the Fund and the assets of the Fund. It also provides that expenses of administering the Fund are paid from the Fund. The Commission has the sole authority to allocate money from the Fund for: (1) the preservation, restoration, maintenance, operation, and development of the French Lick and West Baden historic resort hotels; and (2) infrastructure projects and other improvements in the surrounding community. The bill requires allocations to the two hotels to be divided equally.

Expenditure Limits: Distributions of state revenue to local units of government are dependent on the disposition of state appropriations.

Explanation of Local Revenues:

Tax Restructuring Provisions:

Homestead Credit Increase: The increase in Homestead Credits would not affect local revenues. Homeowners' property tax bills would be reduced by the additional credits, but the state would reimburse local taxing units for the lost revenue.

Inventory Property Tax Credit: This provision would not affect local revenues. Business property owners would continue to pay their property tax bills and then would receive refund checks for the credit amount from the state.

Local Option Income Tax Distributions: Under current law, counties that impose the County Option Income Tax (COIT) may provide a locally funded Homestead Credit up to an additional 8%. COIT revenue that is not used to fund the local Homestead Credit is distributed to civil taxing units (counties, townships, cities, towns, libraries, and special taxing units). A reduction in the net property tax levy would reduce the cost of providing the local Homestead Credit, thereby directing more COIT revenue to civil taxing units.

Personal Property Rules: The Department of Local Government Finance has promulgated new rules governing the assessment of business and utility personal property. These new rules along with their new valuation schedules went into effect for property assessed on the March 1, 2002, assessment date with taxes paid in CY 2003. On average, theses rules would have raised business personal property assessments by 34.3% and reduced utility personal property assessments by 5%. This bill would negate the new rules and require personal property to be assessed under the rules in place on January 1, 2001. Personal property taxpayers who already have filed their March 1, 2002, return would be required to file an amended return, reflecting the old rules.

The overall effect of using both the old business and old utility personal property rules would be a reduction of the expected AV base. This AV reduction would cause an increase in the property tax rates. These rates were used in all of the estimates made elsewhere in this note.

Property Tax Replacement Credit: Total local revenues would not be affected by the change to PTRC. Taxpayers' property tax bills would be reduced by the additional credits, but the state would reimburse local taxing units for the lost revenue.

School General Fund and Transportation Fund Property Tax Levies: Gross school tax levies would not be affected by this proposal. Instead, the state would pay these credits from the PTRF. Since gross levies and gross rates are not affected, there would be no change in the distribution of miscellaneous revenues including Excise Tax, Financial Institutions Tax, and local property tax relief credits from CAGIT proceeds.

Reassessment Phase-in: Under this bill, the changes in valuation on residential property due to the March 1, 2002, reassessment would be phased in over a four-year period. The phase-in would cause some of the property tax burden to shift from residential property to all other types of property through an increased tax rate until the reassessment is fully phased in in 2006. This was considered in all of the estimates made elsewhere in this note.

Shelter Allowance / Standard Deduction: Under the new real property assessment rule recently promulgated by the DLGF, homeowners would receive a shelter allowance against the assessment of their principal residence. These allowances vary by county, ranging from $16,000 to $22,700 and averaging $19,000. Under this proposal, the shelter allowance would be replaced by a $24,000 increase in the standard deduction. This deduction would change from $6,000 to $30,000. The amount of the deduction that exceeds the shelter allowance ($5,000) would cause some of the property tax burden to shift from residential property to all other types of property through an increased tax rate. This was considered in all of the estimates made elsewhere in this note.

Assessment of Rental Housing: Under this proposal, assessing officials would be directed to consider all relevant information in the assessment of rental housing, regardless of whether the information was presented to the township assessor prior to the assessment of the property.

The bill would limit assessors to the use of the capitalization of income method on low income rental housing and would prohibit consideration of tax credits or government subsidies in determining the value of this property. The restrictions on the method of assessment and on the income considered in the assessment of low income rental housing would reduce assessed values statewide by an estimated $50 M. The AV reduction would cause a shift of the property tax burden from the owners of low income rental housing to all taxpayers in the form of an increased tax rate.

Multi-Dwelling Rental Unit Deduction: Under this proposal, rental property would be eligible for a property tax deduction equal to $5,000 for each rental unit that is part of a multi-family dwelling complex. According to Census figures there were about 440,000 rental dwellings in buildings containing at least two dwellings. At $5,000 each, the total statewide deduction is estimated at about $2.2 B. The deduction would cause some of the property tax burden to shift from rental property to all other types of property through an increased tax rate. This was considered in all of the estimates made elsewhere in this note.

Tax Increment Financing: Tax increment financing (TIF) allocations are equal to the incremental assessed value in a TIF area multiplied by the surrounding taxing district's tax rate. Since the gross property tax rate will not be reduced by the credits in the bill, TIF districts' gross property tax receipts would not be adversely affected by the proposal.

Renter's Deduction: The bill increases the renter's deduction beginning in tax year 2003. Because these changes will decrease Indiana taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result of the bill, experience an indeterminable decrease in revenue from these taxes.

Budget Deficit Reduction Provisions:

Homeowner's Property Tax Deduction/Property Tax Add back: The bill suspends the homeowner's property tax deduction in tax year 2002 and re-institutes the property tax add back in tax years 2002, 2003, and 2004. Because these temporary changes will increase Indiana taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable increase in revenue from these taxes.

Riverboat Gaming: The bill eliminates the Riverboat Admission Tax and replaces local distributions from the Admission Tax with Riverboat Wagering Tax distributions. Under the bill, 25% of the Wagering Tax revenue would be distributed to local units. From the total local share collected from a Riverboat: (1) 25% would be distributed to the county in which the Riverboat is located; (2) 2.5% would be distributed to the Convention and Visitor's Bureau of that county; and (3) the remainder would be distributed either (a) to the city where the riverboat is located if it is on Lake Michigan or is the largest city of an Ohio River county or

(b) the county. The additional Wagering Tax revenue to local units generated by the bill is estimated to total $86.4 M in FY 2003, $89.4 M in FY 2004, and $92.6 M in FY 2005. In terms of replacement, the Admission Tax distribution to local units in FY 2001 totaled approximately $82 M.

Pari-mutuel Pull Tabs: The bill distributes 30% of the Pari-mutuel Pull Tab Wagering Tax revenue to local units. Under the bill pull tab tax revenue generated at the Marion County satellite facilities of both racetracks would be distributed as follows: (1) 41.7% to Indianapolis; (2) 20.8% to the Indianapolis Housing Trust Fund; (3) 12.5% to Marion County; and (4) 25% to Marion County school corporations. Pull tab tax revenue generated at Hoosier Park would be distributed as follows: (1) five-sixths to Anderson and (2) one-sixth to Madison County school corporations. Pull tab revenue generated at Indianapolis Downs would be distributed to Shelby County. The local share of pull tab tax revenue relating to Hoosier Park and Hoosier Park's Marion County satellite facility is estimated to total $13.4 M annually beginning in FY 2004.

Orange County Riverboat: The following Wagering Tax distributions from the Orange County riverboat are made to local units: (1) 35% to the French Lick/West Baden Historic District; (2) 5% each to French Lick and West Baden; and (3) 2% each to the French Lick and West Baden town tourism commissions. The local distribution is estimated to total $10.64 M beginning in FY 2005.

See *Explanation of State Expenditures*, above, regarding use of Motor Vehicle Highway Account funds in the funding of the State Police.

Cigarette Taxes: The increase of the Cigarette Tax and the change in the distribution of Cigarette Tax Fund revenue are expected to increase local revenue. Cigarette Tax Fund revenue is distributed semiannually by the State Auditor to cities and towns based on population. The bill is expected to increase these distributions by approximately $100,000 in FY 2002, $1,278,000 in FY2003, and $1,349,000 in FY 2004.

Hospital Care for the Indigent / County Support for Hospitals Program: The local property tax levy and the hospital payment component of the Hospital Care for the Indigent Program (HCI) is replaced by the new County Support for Hospitals levy and program (CSH). The amount of revenue raised by the property tax levy does not change; the revenue is distributed differently under the new program. Under the CSH program, counties will be responsible for distributing funds directly to the hospitals that provide services to indigent patients. The county will then be responsible for certifying to the Office of Medicaid Policy and Planning (OMPP) that the distributions have been made to the hospitals. The OMPP is required to seek a State Medicaid Plan amendment from the Centers for Medicare and Medicaid Services (CMS) in order to implement this provision. With CMS approval, the state may continue to leverage the county funds as qualifying expenditures for federal Medicaid match. The level of funding for local hospitals may shift somewhat: most hospitals will receive funding at the level provided in FY 2001 under the HCI Program. Two counties, Delaware and Marion will see funding shortfalls under the CSH program from the level of funding received under the HCI program. The bill provides a methodology for addressing this issue but does not specify a source of funding to provide a hold harmless for the hospitals in these two counties. The HCI Program is left in place (with the exception of the levy) so that the state may continue to process the claims of providers of indigent care that are not hospitals. The expenditures for this program component are capped at $2 M annually. The source of funds for these expenditures is not specified in the bill.

State Agencies Affected: Auditor; Department of Education; Department of State Revenue; State Budget Agency; Department of Local Government Finance (State Tax Board); Treasurer; Department of Workforce Development; Department of Environmental Management; Family and Social Services Administration.

<u>Local Agencies Affected:</u> School corporations; Local taxing units; Counties with a local option income tax; Local redevelopment commissions; TIF districts; County auditors.

<u>Information Sources:</u> Department of State Revenue; Department of Education; State Tax Board (Department of Local Government Finance), State Police, Department of Environmental Management; Revenue Technical Committee's November 14, 2001, Revenue Forecast; <u>Property Tax Analysis</u>, various years, Local Government Database- State Board of Tax Commissioners (Department of Local Government Finance); School Finance Database; Dan Bastin, Auditor of State's Office; National Science Foundation, *Survey of Industry Research and Development;* <u>Statistical Abstract</u>, 2000, U.S. Bureau of the Census; U.S. Bureau of Labor Statistics, *1995 Survey of Employer-Provided Training: Employer Results*, July 10, 1996; Amy Brown, Legislative Director for the Family and Social Services Administration, Allison Becker, FSSA Division of Disability, Aging and Rehabilitative Services.